

City of Grayling

FINANCIAL STATEMENTS

**For the Fiscal Year Ended
June 30, 2008**



REHMANN ROBSON

Certified Public Accountants

CITY OF GRAYLING, MICHIGAN

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INDEPENDENT AUDITORS' REPORT

December 26, 2008

The Honorable Mayor, Members of
the City Council and City Manager
City of Grayling
Grayling, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the component unit, each major fund, and the aggregate remaining fund information of the **City of Grayling, Michigan** (the "City") as of and for the year ended June 30, 2008, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Grayling Housing Commission, a discretely presented component unit. Those financial statements are audited by other auditors whose audit reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Grayling Housing Commission, is based solely on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the component unit, each major fund, and the aggregate remaining fund information of the **City of Grayling, Michigan**, as of June 30, 2008, and the respective changes in financial position and cash flows, where applicable, thereof, and the respective budgetary comparison for the general and each major special revenue fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The City has not presented Management's Discussion and Analysis as required supplementary information. The GASB has determined that such information is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The combining and individual fund financial statements listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink, reading "Lehmann Lohman". The signature is written in a cursive style with a large, prominent 'L' at the beginning.

BASIC FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

CITY OF GRAYLING
STATEMENT OF NET ASSETS
June 30, 2008

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Housing Commission 3/31/2008
Assets				
Cash and cash equivalents	\$ 2,673,534	\$ 946,008	\$ 3,619,542	\$ 157,032
Investments	602,233	-	602,233	54,514
Receivables	273,013	266,178	539,191	3,655
Prepaid expenditures	-	-	-	5,285
Inventory	-	18,900	18,900	2,475
Capital assets not being depreciated	215,764	907,257	1,123,021	88,873
Capital assets being depreciated, net	6,469,478	5,237,912	11,707,390	1,059,199
Total assets	10,234,022	7,376,255	17,610,277	1,371,033
Liabilities				
Accounts payable	123,166	56,626	179,792	18,356
Accrued liabilities	-	-	-	70,030
Unearned revenue	183,242	-	183,242	-
Long-term liabilities:				
Due within one year	89,016	37,000	126,016	-
Due in more than one year	854,586	1,491,000	2,345,586	39,640
Total liabilities	1,250,010	1,584,626	2,834,636	128,026
Net assets				
Invested in capital assets, net of related debt	5,780,391	4,617,169	10,397,560	1,148,072
Restricted for:				
Debt service	-	48,776	48,776	100,180
Unrestricted (deficit)	3,203,621	1,125,684	4,329,305	(5,245)
Total net assets	\$ 8,984,012	\$ 5,791,629	\$ 14,775,641	\$ 1,243,007

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2008

<u>Functions / Programs</u>	<u>Program Revenues</u>				<u>Net (Expense) Revenue</u>
	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
Primary government					
Governmental activities:					
Legislative	\$ 29,382	\$ -	\$ -	\$ -	\$ (29,382)
General government	884,095	334,715	268,863	-	(280,517)
Public safety	939,187	50,019	182,446	-	(706,722)
Public works	850,672	-	147,627	407,698	(295,347)
Recreation and culture	40,074	-	-	-	(40,074)
Interest and fiscal charges on debt	1,169	-	-	-	(1,169)
Total governmental activities	<u>2,744,579</u>	<u>384,734</u>	<u>598,936</u>	<u>407,698</u>	<u>(1,353,211)</u>
Business-type activities:					
Sewer	288,316	376,702	50,676	-	139,062
Water	138,293	213,040	13,700	-	88,447
Total business-type activities	<u>426,609</u>	<u>589,742</u>	<u>64,376</u>	<u>-</u>	<u>227,509</u>
Total primary government	<u>\$3,171,188</u>	<u>\$ 974,476</u>	<u>\$ 663,312</u>	<u>\$ 407,698</u>	<u>\$ (1,125,702)</u>
Component unit					
Housing Commission (3/31/08)	<u>\$ 989,526</u>	<u>\$ 253,082</u>	<u>\$ 713,269</u>	<u>\$ -</u>	<u>\$ (23,175)</u>

Continued...

CITY OF GRAYLING
STATEMENT OF ACTIVITIES (Concluded)
For the Year Ended June 30, 2008

Functions/Programs	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Housing Commission 3/31/2008
Changes in net assets				
Net (expense) revenue	\$ (1,353,211)	\$ 227,509	\$ (1,125,702)	\$ (23,175)
General revenues:				
Property taxes	955,850	-	955,850	-
Income taxes	437,733	-	437,733	-
Unrestricted investment earnings	114,882	23,376	138,258	2,563
Miscellaneous	146,627	1,421	148,048	3,775
Gain from sale of capital assets	10,021	-	10,021	-
Transfers - internal activities	252,432	(252,432)	-	-
Total general revenues and transfers	1,917,545	(227,635)	1,689,910	6,338
Change in net assets	564,334	(126)	564,208	(16,837)
Net assets, beginning of year	8,419,678	5,791,755	14,211,433	1,297,412
Prior period adjustment	-	-	-	(37,568)
Net assets, beginning of year, restated	8,419,678	5,791,755	14,211,433	1,259,844
Net assets, end of year	\$ 8,984,012	\$ 5,791,629	\$ 14,775,641	\$ 1,243,007

The accompanying notes are an integral part of these financial statements

FUND FINANCIAL STATEMENTS

**CITY OF GRAYLING
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2008**

	General	Income Tax Fund	Fire Department Fund	Downtown Development Authority Fund	Nonmajor Governmental Funds	Total
Assets						
Cash and cash equivalents	\$ 1,207,096	\$ 1,340,948	\$ 61,565	\$ -	\$ 63,925	\$2,673,534
Investments	204,859	-	-	-	397,374	602,233
Accounts receivable, net	124,163	34,900	4,477	15,814	22,674	202,028
Due from other funds	15,982	-	8,416	-	-	24,398
Due from other governmental units	70,985	-	-	-	-	70,985
Total assets	<u>\$ 1,623,085</u>	<u>\$ 1,375,848</u>	<u>\$ 74,458</u>	<u>\$ 15,814</u>	<u>\$ 483,973</u>	<u>\$ 3,573,178</u>
Liabilities and fund balances						
Liabilities						
Accounts payable	\$ 21,563	\$ 21	\$ 4,036	\$ 64,817	\$ 5,215	\$ 95,652
Due to other funds	8,416	-	-	-	15,982	24,398
Accrued liabilities	12,583	915	3,530	-	263	17,291
Deferred revenue	-	183,242	-	-	-	183,242
Total liabilities	<u>42,562</u>	<u>184,178</u>	<u>7,566</u>	<u>64,817</u>	<u>21,460</u>	<u>320,583</u>
Fund balances (deficit)						
Unreserved, designated for:						
Capital projects	227,858	-	-	-	-	227,858
Unfunded pension liability	417,535	-	-	-	-	417,535
Rainy Day fund	676,519	215,000	-	-	250,000	1,141,519
Unreserved						
Undesignated, reported in:						
General Fund	258,611	-	-	-	-	258,611
Special Revenue Funds (deficit)	-	976,670	66,892	(49,003)	212,513	1,207,072
Total fund balances (deficit)	<u>1,580,523</u>	<u>1,191,670</u>	<u>66,892</u>	<u>(49,003)</u>	<u>462,513</u>	<u>3,252,595</u>
Total liabilities and fund balances	<u>\$ 1,623,085</u>	<u>\$ 1,375,848</u>	<u>\$ 74,458</u>	<u>\$ 15,814</u>	<u>\$ 483,973</u>	<u>\$ 3,573,178</u>

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
June 30, 2008

Fund balances - total governmental funds	\$ 3,252,595
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Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources, and therefore not reported in the funds.

Add: capital assets	14,852,095
Subtract: accumulated depreciation	(8,166,853)

Certain liabilities, such as bonds payable, are not due and payable in the current period, and therefore are not reported in the funds.

Subtract: bonds payable	(760,000)
Subtract: installment contracts and capital lease payable	(144,851)
Subtract: accrued interest payable	(10,223)
Subtract: compensated absences	(38,751)

Net assets of governmental activities	<u>\$ 8,984,012</u>
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The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
For the Year Ended June 30, 2008

	General	Income Tax Fund	Fire Department Fund	Downtown Development Authority Fund	Nonmajor Governmental Funds	Total
Revenues						
Property taxes	\$ 955,850	\$ -	\$ -	\$ -	\$ -	\$ 955,850
Income tax	-	437,733	-	-	-	437,733
Licenses and permits	2,695	-	-	-	-	2,695
Intergovernmental	274,638	-	182,446	407,698	174,533	1,039,315
Charges for services	149,250	-	52,359	-	20,234	221,843
Interest and rent	60,434	35,457	1,083	1,128	144,295	242,397
Other revenue	142,264	348	1,625	2,390	-	146,627
Total revenues	1,585,131	473,538	237,513	411,216	339,062	3,046,460
Expenditures						
Current:						
Legislative	35,286	-	-	-	-	35,286
General government	627,457	99,139	-	-	-	726,596
Public safety	523,669	-	386,147	-	-	909,816
Public works	558,183	-	-	905,488	83,232	1,546,903
Recreation and culture	16,129	-	-	-	121,643	137,772
Total expenditures	1,760,724	99,139	386,147	905,488	204,875	3,356,373
Revenues over (under) expenditures	(175,593)	374,399	(148,634)	(494,272)	134,187	(309,913)
Other financing sources (uses)						
Sale of capital assets	10,021	-	-	-	-	10,021
Transfers in	739,671	-	215,526	445,269	563,612	1,964,078
Transfers out	(932,043)	(247,076)	-	-	(304,669)	(1,483,788)
Total other financing sources (uses)	(182,351)	(247,076)	215,526	445,269	258,943	490,311
Net change in fund balances	(357,944)	127,323	66,892	(49,003)	393,130	180,398
Fund balances, beginning of year	1,938,467	1,064,347	-	-	69,383	3,072,197
Fund balances (deficit), end of year	\$ 1,580,523	\$ 1,191,670	\$ 66,892	\$ (49,003)	\$ 462,513	\$ 3,252,595

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2008

Net change in fund balances - total governmental funds	\$ 180,398
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Amounts reported for *governmental activities* in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Add: capital outlay	914,902
Subtract: depreciation expense	(366,675)

Loan proceeds provide current financial resources to governmental funds in the period issued, but this increases long-term liabilities in the statement of net assets	(30,000)
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Repayment of long-term liabilities is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.

Add: principal payments on long-term liabilities	72,971
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Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.

Subtract: increase in the accrued interest payable	(1,169)
Add: decrease in the accrual of compensated absences	21,765
Subtract: transfers in from internal service fund	<u>(227,858)</u>

Change in net assets of governmental activities	<u><u>\$ 564,334</u></u>
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The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
GENERAL FUND
For the Year Ended June 30, 2008

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Property taxes	\$ 952,816	\$ 952,816	\$ 955,850	\$ 3,034
Licenses and permits	5,000	5,000	2,695	(2,305)
Intergovernmental	283,731	316,166	274,638	(41,528)
Charges for services	148,542	148,542	149,250	708
Interest and rent	60,000	60,000	60,434	434
Other revenue	500	500	142,264	141,764
Total revenues	1,450,589	1,483,024	1,585,131	102,107
Expenditures				
Current				
Legislative	37,374	37,374	35,286	(2,088)
General government	694,479	697,479	627,457	(70,022)
Public safety	531,532	560,967	523,669	(37,298)
Public works	572,371	572,371	558,183	(14,188)
Recreation and culture	16,789	16,789	16,129	(660)
Total expenditures	1,852,545	1,884,980	1,760,724	(124,256)
Revenues over (under) expenditures	(401,956)	(401,956)	(175,593)	226,363
Other financing sources (uses)				
Sale of capital assets	21,035	21,035	10,021	(11,014)
Transfers in	747,124	747,124	739,671	(7,453)
Transfers out	(868,265)	(941,685)	(932,043)	9,642
Total other financing sources (uses)	(100,106)	(173,526)	(182,351)	(8,825)
Net change in fund balance	(502,062)	(575,482)	(357,944)	217,538
Fund balance, beginning of year	1,961,807	1,961,807	1,938,467	(23,340)
Fund balance, end of year	\$ 1,459,745	\$ 1,386,325	\$ 1,580,523	\$ 194,198

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
INCOME TAX FUND
For the Year Ended June 30, 2008

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Income tax	\$ 445,000	\$ 445,000	\$ 437,733	\$ (7,267)
Intergovernmental	-	-	-	-
Interest and rent	32,000	32,000	35,457	3,457
Miscellaneous revenue	-	-	348	348
Total revenues	477,000	477,000	473,538	(3,462)
Expenditures				
General government	107,504	107,504	99,139	(8,365)
Revenues over expenditures	369,496	369,496	374,399	4,903
Other financing sources uses				
Transfers out	(308,500)	(270,000)	(247,076)	22,924
Net change in fund balance	60,996	99,496	127,323	27,827
Fund balance, beginning of year	1,064,347	1,064,347	1,064,347	-
Fund balance, end of year	<u>\$ 1,125,343</u>	<u>\$ 1,163,843</u>	<u>\$ 1,191,670</u>	<u>\$ 27,827</u>

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
FIRE DEPARTMENT FUND
For the Year Ended June 30, 2008

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Intergovernmental	\$ 148,936	\$ 174,993	\$ 182,446	\$ 7,453
Charges for services	51,000	51,000	52,359	1,359
Interest and rent	-	-	1,083	1,083
Other revenue	500	500	1,625	1,125
Total revenues	200,436	226,493	237,513	11,020
Expenditures				
Public safety	314,078	403,075	386,147	(16,928)
Revenues over (under) expenditures	(113,642)	(176,582)	(148,634)	27,948
Other financing sources				
Transfers in	113,642	134,560	215,526	80,966
Net change in fund balance	-	(42,022)	66,892	108,914
Fund balance, beginning of year	-	-	-	-
Fund balance, end of year	<u>\$ -</u>	<u>\$ (42,022)</u>	<u>\$ 66,892</u>	<u>\$ 108,914</u>

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
DOWNTOWN DEVELOPMENT AUTHORITY FUND
For the Year Ended June 30, 2008

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Intergovernmental	\$ 534,767	\$ 534,767	\$ 407,698	\$ (127,069)
Charges for services	-	-	-	-
Interest and rent	-	-	1,128	1,128
Other revenue	1,500	1,500	2,390	890
Total revenues	536,267	536,267	411,216	(125,051)
Expenditures				
Public works	1,227,000	1,228,719	905,488	(323,231)
Revenues over (under) expenditures	(690,733)	(692,452)	(494,272)	198,180
Other financing sources				
Transfers in	466,555	468,272	445,269	(23,003)
Net change in fund balance	(224,178)	(224,180)	(49,003)	175,177
Fund balance, beginning of year	-	-	-	-
Fund balance (deficit), end of year	<u>\$ (224,178)</u>	<u>\$ (224,180)</u>	<u>\$ (49,003)</u>	<u>\$ 175,177</u>

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
June 30, 2008

	Business-type Activities			Governmental Activities
	Enterprise Funds			Internal Service Fund
	Sewer	Water	Total	
Assets				
Current assets:				
Cash and cash equivalents	\$ 731,236	\$ 214,772	\$ 946,008	\$ -
Accounts receivable, net	182,320	83,858	266,178	-
Inventory	12,285	6,615	18,900	-
Total current assets	925,841	305,245	1,231,086	-
Non-current assets				
Capital assets, net	5,361,411	783,758	6,145,169	-
Total assets	6,287,252	1,089,003	7,376,255	-
Liabilities				
Current liabilities:				
Accounts payable	18,143	283	18,426	-
Accrued expenses	23,119	15,081	38,200	-
Bonds and contracts payable, current	22,000	15,000	37,000	-
Total current liabilities	63,262	30,364	93,626	-
Long-term liabilities -				
Bonds and contracts payable	887,000	604,000	1,491,000	-
Total liabilities	950,262	634,364	1,584,626	-
Net assets				
Investment in capital assets, net of related debt	4,452,411	164,758	4,617,169	-
Restricted for:				
Debt service	29,362	19,414	48,776	-
Unrestricted	855,217	270,467	1,125,684	-
Total net assets	\$ 5,336,990	\$ 454,639	\$ 5,791,629	\$ -

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
STATEMENT OF REVENUE, EXPENSES AND
CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
For the Year Ended June 30, 2008

	Business-type Activities			Governmental Activities
	Enterprise Funds			Internal Service Fund
	Sewer	Water	Total	
Operating revenues				
Charges for services	\$ 376,702	\$ 213,040	\$ 589,742	\$ -
Other revenue	755	666	1,421	-
Total operating revenues	377,457	213,706	591,163	-
Operating expenses				
Administrative services	30,518	21,835	52,353	-
Supplies	3,412	7,556	10,968	-
Contractual and other	15,497	22,354	37,851	-
Utilities	35,421	19,585	55,006	-
Repair and maintenance	21,372	3,069	24,441	-
Depreciation	135,852	33,738	169,590	-
Total operating expenses	242,072	108,137	350,209	-
Operating income	135,385	105,569	240,954	-
Nonoperating revenues (expenses)				
Investment earnings	16,939	6,437	23,376	-
Intergovernmental	50,676	13,700	64,376	-
Interest expense	(46,244)	(30,156)	(76,400)	-
Total nonoperating revenues (expenses)	21,371	(10,019)	11,352	-
Income before transfers and contributions	156,756	95,550	252,306	-
Transfers in	-	400	400	-
Transfers out	(148,851)	(103,981)	(252,832)	(227,858)
Capital contributed to governmental activities	-	-	-	(586,131)
Changes in net assets	7,905	(8,031)	(126)	(813,989)
Net assets, beginning of year	5,329,085	462,670	5,791,755	813,989
Net assets, end of year	\$ 5,336,990	\$ 454,639	\$ 5,791,629	\$ -

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
For the Year Ended June 30, 2008

	Business-type Activities			Governmental Activities
	Enterprise Funds			Internal Service Fund
	Sewer	Water	Total	
Cash flows from operating activities				
Cash received from customers and users	\$ 462,963	\$ 206,332	\$ 669,295	\$ -
Cash payments to suppliers for goods and services	(97,720)	(70,109)	(167,829)	-
Cash payments to employees for services	(31,609)	(23,491)	(55,100)	-
Net cash provided by operating activities	333,634	112,732	446,366	-
Cash flows from noncapital financing activities				
Interest income	16,939	6,437	23,376	-
Intergovernmental	50,676	13,700	64,376	-
Transfers in	-	400	400	
Transfers out	(148,851)	(103,981)	(252,832)	(234,571)
Net cash used in noncapital financing activities	(81,236)	(83,444)	(164,680)	(234,571)
Cash flows from capital and related financing activities				
Purchase and construction of capital assets	(56,881)	-	(56,881)	-
Principal paid on capital debt	(20,000)	(14,000)	(34,000)	-
Interest paid on capital debt	(46,244)	(30,156)	(76,400)	-
Net cash used by capital and related financing activities	(123,125)	(44,156)	(167,281)	-
Net increase (decrease) in cash and cash equivalents	129,273	(14,868)	114,405	(234,571)
Cash and cash equivalents, beginning of year	601,963	229,640	831,603	234,571
Cash and cash equivalents, end of year	\$ 731,236	\$ 214,772	\$ 946,008	\$ -
Reconciliation of operating income to net cash provided (used) by operating activities				
Operating income	\$ 135,385	\$ 105,569	\$ 240,954	\$ -
Adjustments to reconcile operating income to net cash provided (used) by operating activities:				
Depreciation	135,852	33,738	169,590	-
Changes in assets and liabilities:				
Accounts receivable	85,506	(7,374)	78,132	-
Inventory	-	-	-	-
Accounts payable	(22,018)	(17,545)	(39,563)	-
Accrued liabilities	(1,091)	(1,656)	(2,747)	-
Net cash provided by operating activities	\$ 333,634	\$ 112,732	\$ 446,366	\$ -

The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING
STATEMENT OF FIDUCIARY NET ASSETS
AGENCY FUND
June 30, 2008

Assets

Cash and cash equivalents	\$ 271
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Liabilities

Accounts payable	\$ 271
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The accompanying notes are an integral part of these financial statements

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting entity

The ***City of Grayling*** (the "City") is directed by a City Council elected by the community at large. This legislative body appoints a City Manager to administer the affairs of the City. The City provides the following services as authorized by its charter: public safety (police and fire), highways and streets, cemetery, sanitation, health and social services, culture and recreation, public improvements, planning and zoning and general administrative services. The City has adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 14 and Statement No. 39, regarding the definition of the reporting entity.

GASB 14 and 39 provide states that the primary basis for determining whether outside agencies and organizations should be considered component units of the City and included in the City's financial statements is financial accountability. Financial accountability has been defined as follows: a primary government has substantive authority to appoint a voting majority of the component unit's board; the primary government is either able to impose its will on a component unit or there is a potential for the component unit to provide specific financial burdens on the primary government; and the component unit is fiscally dependent on the primary government. The City's only component unit is the Grayling Housing Commission.

Discretely Presented Component Unit

The Grayling Housing Commission is governed by a five-member board appointed by the City Manager. The Commission's fiscal year end is March 31, 2008. A complete financial statement of the Housing Commission can be obtained from the Executive Director, City of Grayling Housing Commission, 308 Lawndale Drive, Grayling, Michigan 49738.

B. Government-wide and fund financial statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component unit. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental and enterprise funds are reported as separate columns in the respective fund financial statements.

The City reports the following major governmental funds:

The *general fund* is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The *income tax fund* accounts for the proceeds from the City income tax collections. These collections are reserved for capital improvements.

The *fire department fund* accounts for the activities of the fire department.

The *downtown development authority fund* accounts for certain projects and activities whose purpose is to revitalize the downtown business district.

The *water and sewer funds* are the City's major enterprise funds. They account for the activities of the City's water distribution and sewage disposal and treatment systems.

Additionally, the City reports the following nonmajor fund types:

The *special revenue funds* account for the use of money received from the State of Michigan under the revenue sharing guidelines of Public Act 51, the activities of the cemetery and rental and maintenance activities.

The *internal service fund* accounts for fleet and equipment management to other departments or agencies of the City, or to other governments, on a cost reimbursement basis. This fund was closed effective July 1, 2007 and its net assets transferred to the City's general fund and governmental activities.

The *agency fund* accounts for the collection and payments of assets held for other governments in an agency capacity, primarily property tax levies.

C. Measurement focus, basis of accounting, and financial statement presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund and fiduciary fund financial statements, except for agency funds, which do not have a measurement focus. Revenues are recorded when earned and expenses are recorded when liabilities are incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting; however, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, state-shared revenue, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the City.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the government's water and sewer function, cost of building rent and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Water and Sewer Enterprise Funds and of the government's Motor Pool Internal Service Fund are charges to customers for sales and services. The enterprise funds also recognize as operating revenues the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for enterprise funds and the internal service fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, and then use unrestricted resources as they are needed.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

D. Assets, liabilities and equity

1. *Deposits and investments*

The City's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

Investments are stated at fair market value.

2. *Receivables and payables*

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year and all other outstanding balances between funds are referred to as "due to/from other funds" (i.e., the current portion of interfund loans). Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

3. *Inventory*

Inventory (if held) by the enterprise funds is valued at cost on the first-in, first-out basis. Inventory of expendable supplies in other funds have not been recorded and the amount of any such inventories is not considered material. The cost value of such inventories has been treated as an expenditure at the time of purchase.

4. *Capital assets*

Capital assets, which include property, plant, equipment and infrastructure assets (i.e., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities, if any, is included as part of the capitalized value of the assets constructed. No such interest expense was incurred during the current fiscal year.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Capital assets of the primary government and component unit are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	40-60
Building improvements	15-30
Water and sewer lines	50-75
Streets, curbs and gutters	10-30
Vehicles	3-5
Equipment	5-7

5. *Compensated absences*

Vacation days for the City's salaried and some hourly employees are determined by the City's personnel policies; the remaining hourly employees are determined by the union agreement between the City and the employees' union. The liability for this amount is included in the government-wide and proprietary fund financial statements. A liability for this amount is reported in governmental funds only if they have matured, for example, as a result of employee resignations or retirements.

6. *Long-term obligations*

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

7. *Fund equity*

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

II. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary information

Annual budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America for all operating funds of the City except for the agency fund. State law requires that budgets be adopted for the general and special revenue funds.

The City follows the following procedures in establishing the budgetary data reflected in the financial statements:

1. Prior to the first Council meeting in May, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures/expenses and the means of financing them.
2. A public hearing is conducted at City Hall to obtain taxpayer comments.
3. Prior to July 1, the fund budgets are legally adopted at the activity level and enacted through passage of resolutions.
4. The City Manager is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures/expenses of any fund must be approved by the City Council.
5. Formal budgetary integration is employed as a management control device during the year for the general and special revenue funds.
6. Budgeted amounts are as originally adopted, or as amended by the City Council.
7. Encumbrances, which are commitments related to unperformed contracts for goods or services, lapse at year-end and are re-appropriated as part of the subsequent year's budget.

B. Excess of expenditures over appropriations

For the year ended June 30, 2008, the City did not incur any expenditures at the activity level in the general or special revenue funds that exceeded appropriations.

C. Deficit fund balance

The Downtown Development Authority Fund ended the year with a fund deficit of \$49,003.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

III. DETAILED NOTES ON ALL FUNDS

A. Deposits and investments

Michigan Compiled Laws, Section 129.91 authorizes the local government unit to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations, which have an office in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; bankers' acceptance of United States banks; commercial paper rated within the two highest classifications which mature not more than 270 days after the date of purchase; obligations of the state of Michigan or its political subdivisions which are rated as investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan.

The City Council has designated six banks for the deposit of City funds. The investment policy adopted by the Council has authorized all allowable investments in accordance with Public Act 20 of 1943.

The City's deposit and investment policy are in accordance with statutory authority.

A reconciliation of cash and investments as shown on the statement of net assets and statement of fiduciary net assets to deposits and investments as classified for note disclosure purposes is as follows:

	<u>Primary Government</u>	<u>Component Unit</u>
Cash and cash equivalents		
Statement of net assets	\$ 3,619,542	\$ 157,032
Statement of fiduciary net assets	271	-
Total cash and cash equivalents	3,619,813	157,032
Investments		
Statement of net assets	602,233	54,514
	<u>\$ 4,222,046</u>	<u>\$ 211,546</u>
Bank deposits (checking accounts)	\$ 4,102,987	\$ 211,546
Common stock	118,859	-
Cash on hand	200	-
	<u>\$ 4,222,046</u>	<u>\$ 211,546</u>

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

As of June 30, 2008, the City held investments in common stock of the Principal Financial Group, Inc. with a fair value of \$118,859.

In July 1971, the City purchased a single premium group annuity contract from Principal Mutual Life Insurance Company for the purpose of funding a defined benefit plan. This contract was used to provide retirement payments to participants covered under this defined benefit pension plan. This contract will remain active until Principal makes the last annuity payment to the last living person entitled to benefits under the contract. Because the contract was active when Principal Mutual Holding Company became a publicly held company, the City was eligible for demutualization compensation. As a result, the City recently discovered that it had received 2,832 shares of Principal Financial Group, Inc. stock. The demutualization compensation has no bearing on the existing retirement benefits for the remaining retirees receiving benefits from the annuity contract.

Investment and deposit risk

Interest Rate Risk. State law limits the allowable investments and the maturities of some of those investments as identified above. The City's investment policy does not have specific limits that differ from state law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The weighted average maturity dates for investments are identified above for investments held at year-end.

Credit Risk. The City's investment policy does not have specific limits that differ from state law on investment credit risk.

Custodial Credit Risk – Deposits. Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned. State law does not require and the City does not have a policy for deposit custodial credit risk. As of year end, \$2,798,743 of the City's bank balance of \$4,115,508 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial Credit Risk – Investments. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. State law does not require and the City does not have a policy for investment custodial credit risk. Of the above \$118,859 of investments, the City has a custodial credit risk exposure of \$118,859 because the related securities are uninsured, unregistered and held by the government's brokerage firm which is also the counterparty for these particular securities.

Concentration of Credit Risk. State law limits allowable investments but does not limit concentration of credit risk as identified on the previous page. The City's investment policy also does not have specific limits in concentration of credit risk. The City holds only one investment which therefore represents 100 percent of the City's total investments.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

B. Receivables

Receivables in the City's governmental activities consist of receivables due from other governments and amounts due from individuals for income taxes. Receivables in the business-type activities consist of receivables due from customers.

C. Capital assets

Primary Government

Capital asset activity of the City's governmental and business-type activities was as follows:

	<u>July 1, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2008</u>
Governmental activities				
Capital assets not being depreciated:				
Land	<u>\$ 215,764</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 215,764</u>
Capital assets being depreciated:				
Infrastructure	8,095,746	870,625	-	8,966,371
Equipment	2,966,020	44,277	(65,381)	2,944,916
Buildings	<u>2,725,044</u>	<u>-</u>	<u>-</u>	<u>2,725,044</u>
Total capital assets being depreciated	<u>13,786,810</u>	<u>914,902</u>	<u>(65,381)</u>	<u>14,636,331</u>
Less accumulated depreciation:				
Infrastructure	(5,847,478)	(124,558)	-	(5,972,036)
Equipment	(1,468,334)	(178,671)	65,381	(1,581,624)
Buildings	<u>(549,747)</u>	<u>(63,446)</u>	<u>-</u>	<u>(613,193)</u>
Total accumulated depreciation	<u>(7,865,559)</u>	<u>(366,675)</u>	<u>65,381</u>	<u>(8,166,853)</u>
Total capital assets being depreciated, net	<u>5,921,251</u>	<u>548,227</u>	<u>-</u>	<u>6,469,478</u>
Governmental activities capital assets, net	<u>\$ 6,137,015</u>	<u>\$ 548,227</u>	<u>\$ -</u>	<u>\$ 6,685,242</u>

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

	<u>July 1, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2008</u>
Business-type activities				
Capital assets not being depreciated:				
Construction in progress	\$ 850,376	\$ 56,881	\$ -	\$ 907,257
Capital assets being depreciated:				
Infrastructure	8,504,578	-	-	8,504,578
Equipment	<u>100,687</u>	<u>-</u>	<u>-</u>	<u>100,687</u>
Total capital assets being depreciated	<u>8,605,265</u>	<u>-</u>	<u>-</u>	<u>8,605,265</u>
Less accumulated depreciation:				
Infrastructure	(3,120,346)	(168,839)	-	(3,289,185)
Equipment	<u>(77,416)</u>	<u>(751)</u>	<u>-</u>	<u>(78,167)</u>
Total accumulated depreciation	<u>(3,197,762)</u>	<u>(169,590)</u>	<u>-</u>	<u>(3,367,352)</u>
Total capital assets being depreciated, net	<u>5,407,503</u>	<u>(169,590)</u>	<u>-</u>	<u>5,237,912</u>
Business-type activities capital assets, net	<u>\$ 6,257,879</u>	<u>\$ (112,709)</u>	<u>\$ -</u>	<u>\$ 6,145,170</u>

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities	
General government	\$ 60,340
Public safety	102,703
Public works	179,687
Culture and recreation	<u>23,945</u>
Total depreciation expense – governmental activities	<u>\$ 366,675</u>
Business-type activities	
Water	\$ 135,852
Sewer	<u>33,738</u>
Total depreciation expense – business-type activities	<u>\$ 169,590</u>

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

	<u>April 1,</u> <u>2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>March 31,</u> <u>2008</u>
Housing Commission				
Component Unit				
Capital assets not being depreciated:				
Construction in progress	\$ 88,873	\$ -	\$ -	\$ 88,873
Capital assets being depreciated:				
Buildings and improvements	2,519,358	5,445	-	2,524,803
Equipment	<u>218,209</u>	<u>3,909</u>	<u>(17,819)</u>	<u>204,299</u>
Total capital assets being depreciated	<u>2,737,567</u>	<u>9,354</u>	<u>(17,819)</u>	<u>2,729,102</u>
Accumulated depreciation	<u>(1,598,540)</u>	<u>(89,182)</u>	<u>17,819</u>	<u>(1,669,903)</u>
Total capital assets being depreciated, net	<u>1,139,027</u>	<u>(79,828)</u>	<u>-</u>	<u>1,059,199</u>
Housing Commission capital assets, net	<u>\$ 1,227,900</u>	<u>\$ (79,828)</u>	<u>\$ -</u>	<u>\$ 1,148,072</u>

D. Interfund transfers

The composition of interfund transfers is as follows:

	<u>Transfers in</u>	<u>Transfers out</u>
General fund	\$ 739,671	\$ 932,043
Income tax fund	-	247,076
Fire department fund	215,526	-
Downtown development authority fund	445,269	-
Non-major governmental funds	563,612	304,669
Water funds	400	103,981
Sewer funds	-	148,851
Internal service fund	<u>-</u>	<u>227,858</u>
Total	<u>\$ 1,964,478</u>	<u>\$ 1,964,478</u>

The operating transfers are mainly for street improvements, general city operations, debt service and capital improvements.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

E. Long-term debt

Following is a summary of bonds and notes payable of the City for the year ending June 30, 2008:

<u>Purpose</u>	<u>Maturity Date</u>	<u>Interest Rates</u>	<u>Amount</u>
Governmental activities			
2003 General Obligation Bond	2022	2.0-5.0%	\$ 760,000
Installment Note Payable	2010	3.75%	114,851
Purchase Contract	2012	4.13%	<u>30,000</u>
			<u>\$ 904,851</u>
Business-type activities			
1991A Water and Sewer Bond	2030	5.0%	\$ 909,000
1991B Water and Sewer Bond	2030	5.0%	<u>619,000</u>
			<u>\$ 1,528,000</u>

Annual debt service requirements to maturity for governmental activities and business-type activities are as follows:

<u>Year Ending June 30,</u>	<u>Governmental Activities</u>		<u>Business-type Activities</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 85,141	\$ 38,301	\$ 37,000	\$ 75,475
2010	87,112	35,219	38,000	73,600
2011	64,848	32,049	40,000	71,650
2012	46,250	29,997	42,000	69,600
2013	46,500	28,114	44,000	67,450
2014-2018	245,000	109,975	259,000	300,625
2019-2023	330,000	42,648	331,000	227,225
2024-2028	-	-	425,000	133,225
2029-2031	<u>-</u>	<u>-</u>	<u>312,000</u>	<u>23,900</u>
Total	<u>\$ 904,851</u>	<u>\$ 316,303</u>	<u>\$ 1,528,000</u>	<u>\$ 1,042,000</u>

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Changes in long-term liabilities. Long-term liability activity was as follows:

	<u>July 1, 2007</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2008</u>	<u>Due Within One Year</u>
<u>Primary Government</u>					
Governmental activities					
General obligation					
bonds	\$ 790,000	\$ -	\$ (30,000)	\$ 760,000	\$ 35,000
Notes payable	157,822	-	(42,971)	114,851	44,641
Purchase contract	-	30,000	-	30,000	5,500
Compensated absences	60,516	-	(21,765)	38,751	3,875
	<u>\$ 1,008,338</u>	<u>\$ 30,000</u>	<u>\$ (94,736)</u>	<u>\$ 943,602</u>	<u>\$ 89,016</u>
Business-type activities					
Revenue obligation					
bonds	<u>\$ 1,562,000</u>	<u>\$ -</u>	<u>\$ (34,000)</u>	<u>\$ 1,528,000</u>	<u>\$ 37,000</u>

For the governmental activities, compensated absences are generally liquidated by the general fund.

The long-term debt reported for the Housing Commission of \$39,640 consists entirely of accrued compensated absences.

IV. OTHER INFORMATION

A. Risk management

The City is exposed to various risks of loss related to property loss, torts, errors and omissions and employee injuries (workers' compensation), as well as medical benefits provided to employees. The City belongs to the Michigan Municipal League Liability and Property Pool, a public entity risk pool currently operating as a common risk management and insurance program for various municipalities throughout the state. The City pays an annual premium for its general insurance coverage. The pool is self-sustaining through member premiums and reinsures through commercial companies for claims in excess of \$500,000 for each insured event. Although the City could be assessed charges beyond the annual premium, the likelihood of receiving such an assessment is minimal. Settled claims have not exceeded coverage in any of the past three years.

B. Property taxes

Property taxes are levied and become a lien on property as of July 1 on the State taxable valuation of property in the City as of the preceding December 31. The City bills and collects its own property taxes and also collects taxes for other governmental units. Collections of other governmental unit's taxes and remittance of them to the units are accounted for in the Agency Fund. Property taxes are recognized as revenue in the year for which they are levied.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

The City is permitted by charter to levy taxes, subject to State Headlee and Truth in Taxation provisions, up to \$20 per \$1,000 of taxable valuation for general governmental services and for the payment of principal and interest on general obligation long-term debt. The 2007 State taxable valuation of the City of Grayling totaled \$59,609,728.

The government's general operating tax rate for fiscal year 2008 was 14.80 mills.

C. Defined contribution plan

The City provides pension benefits for certain employees as designated by City Council through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. As of July 1, 2004, employees are eligible to participate from the date of employment. The City's contributions for each employee (and interest allocated to each employee's account) are fully vested after four years.

In 2003, all existing employees were given the choice of converting from the defined benefit plan to the defined contribution plan. Those employees who elected to convert, along with all new hires after July 1, 2004, are participants only in the defined contribution plan.

As established by City Council and governed by Federal Regulations, the City made the required 11% contribution. Contributions for the year totaled \$30,882 for the eight employees that participate in this plan. There are no contribution requirements for employees of the City of Grayling.

D. Defined benefit pension plan

Plan Description

The City's defined benefit pension plan provides retirement and disability benefits, annual cost-of-living adjustments and death benefits to plan members and beneficiaries. The City participates in the Municipal Employees Retirement System of Michigan (MERS), an agent multiple-employer plan administered by the MERS Retirement Board. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. The Municipal Employees Retirement System of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to the Municipal Employees Retirement System of Michigan, 447 N. Canal Road, Lansing, MI 48917 or by calling (800) 767-6377.

Funding Policy

The City is required to contribute at an actuarially determined rate; the current rate is 10.78% of annual covered payroll. Employees are currently not required to contribute to the Plan. The contribution requirements of the City are established and may be amended by the MERS Retirement Board. The contribution requirements of plan members, if any, are established and may be amended by the City depending on the MERS contribution program adopted by the City.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Annual Pension Cost

For the year ended June 30, 2008, the City's annual pension cost of \$94,699 for MERS was equal to the City's required and actual contributions. The required contribution was determined as part of the initial actuarial valuation using the entry age actuarial cost method. The actuarial assumption included (a) a rate of return on the investment of present and future assets of 8.0%, (b) additional projected salary increases of 0.0% to 4.5% per year, depending on age, attributable to seniority/merit and (c) projected salary increases of 4.5% per year, compounded annually, attributable to inflation. The actuarial value of MERS assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return and includes an adjustment to reflect fair value. The City's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The amortization period at initial valuation was 30 years.

Trend Information

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/06	\$ 76,517	100%	\$ -
6/30/07	92,329	100%	-
6/30/08	94,699	100%	-

Schedule of Funding Progress

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) -Entry Age (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a Percentage of Covered Payroll ((b-a)/c)</u>
12/31/2005	\$ 2,275,804	\$ 2,699,947	\$ 424,143	84%	\$ 813,650	52%
12/31/2006	2,456,343	2,863,043	406,700	86%	839,223	48%
12/31/2007	2,650,315	3,179,471	529,156	83%	767,780	69%

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

E. Designated Fund Balances / Restricted Net Assets

Major Governmental Funds. The general fund has \$ 417,535 designated for unfunded pension liabilities, \$227,858 for capital projects, and \$676,519 for “rainy day” purposes. The income tax fund has \$215,000 designated for future capital improvement projects.

Nonmajor Governmental Funds. The cemetery fund has \$250,000 designated for “rainy day” purposes.

Major Proprietary Funds. The water fund has \$19,414 of its net assets restricted due to revenue bond indentures. The sewer fund has \$29,362 of its net assets restricted due to bond indentures.

F. Other postemployment benefits

The City provides postemployment benefits of health insurance to eligible employees. For the year ended June 30, 2008, there was one participant. The City’s actual expense was \$12,128.

G. Contingencies and commitments

In the normal course of its activities, the City is a party to various legal actions. After taking into consideration legal counsel’s evaluation of pending actions, the City is of the opinion that the potential claims not covered by insurance will not have a material effect on the financial statements.

The general fund is contingently liable for the water and sewer system revenue bonds. The general fund is obligated only if revenues of the water and sewer system funds would be insufficient to meet its debt service requirements.

In addition, the City has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under terms of the grants, management believes that any required reimbursements would not be material.

H. Restatement – Housing Commission

An error in the recording of capital assets of the Housing Commission was corrected during the Housing Commission’s audit for the year ended March 31, 2008 which resulted in a reduction of opening net assets at April 1, 2007 in the amount of \$37,568.

* * * * *

CITY OF GRAYLING
NONMAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
June 30, 2008

	Special Revenue Funds				Total Nonmajor Governmental Funds
	Major Street	Local Street	Cemetery	Municipal Holdings	
Assets					
Cash and cash equivalents	\$ -	\$ 12	\$ 34,948	\$ 28,965	\$ 63,925
Investments	-	-	397,374	-	397,374
Accounts receivable	15,590	7,084	-	-	22,674
Total assets	<u>\$ 15,590</u>	<u>\$ 7,096</u>	<u>\$ 432,322</u>	<u>\$ 28,965</u>	<u>\$ 483,973</u>
Liabilities and fund balances					
Liabilities					
Accounts payable	\$ 568	\$ -	\$ 3,997	\$ 650	\$ 5,215
Due to other funds	10,371	-	5,611	-	15,982
Accrued liabilities	-	-	-	263	263
Total liabilities	<u>10,939</u>	<u>-</u>	<u>9,608</u>	<u>913</u>	<u>21,460</u>
Fund Balances					
Unreserved, designated for:					
Rainy day fund	-	-	250,000	-	250,000
Unreserved, undesignated	4,651	7,096	172,714	28,052	212,513
Total fund balances	<u>4,651</u>	<u>7,096</u>	<u>422,714</u>	<u>28,052</u>	<u>462,513</u>
Total liabilities and fund balances	<u>\$ 15,590</u>	<u>\$ 7,096</u>	<u>\$ 432,322</u>	<u>\$ 28,965</u>	<u>\$ 483,973</u>

CITY OF GRAYLING
NONMAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
For the Year Ended June 30, 2008

	Special Revenue Funds				Total Nonmajor Governmental Funds
	Major Street	Local Street	Cemetery	Municipal Holdings	
Revenues					
Intergovernmental	\$ 100,223	\$ 47,404	\$ 26,906	\$ -	\$ 174,533
Charges for services	-	-	20,234	-	20,234
Interest and rent	470	41	16,033	127,751	144,295
Total revenues	<u>100,693</u>	<u>47,445</u>	<u>63,173</u>	<u>127,751</u>	<u>339,062</u>
Expenditures					
Current:					
Public works	57,587	25,645	-	-	83,232
General government	-	-	59,525	62,118	121,643
Total expenditures	<u>57,587</u>	<u>25,645</u>	<u>59,525</u>	<u>62,118</u>	<u>204,875</u>
Revenues over expenditures	<u>43,106</u>	<u>21,800</u>	<u>3,648</u>	<u>65,633</u>	<u>134,187</u>
Other financing sources (uses)					
Transfers in	20,000	73,018	470,594	-	563,612
Transfers out	(122,014)	(93,546)	(51,528)	(37,581)	(304,669)
Total other financing sources (uses)	<u>(102,014)</u>	<u>(20,528)</u>	<u>419,066</u>	<u>(37,581)</u>	<u>258,943</u>
Net change in fund balances	<u>(58,908)</u>	<u>1,272</u>	<u>422,714</u>	<u>28,052</u>	<u>393,130</u>
Fund balances, beginning of year	<u>63,559</u>	<u>5,824</u>	<u>-</u>	<u>-</u>	<u>69,383</u>
Fund balances, end of year	<u>\$ 4,651</u>	<u>\$ 7,096</u>	<u>\$ 422,714</u>	<u>\$ 28,052</u>	<u>\$ 462,513</u>

CITY OF GRAYLING
STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
MAJOR STREET FUND
For the Year Ended June 30, 2008

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Intergovernmental	\$ 625,467	\$ 98,967	\$ 100,223	\$ 1,256
Interest and rent	4,000	4,000	470	(3,530)
Other	58,500	-	-	-
Total revenues	<u>687,967</u>	<u>102,967</u>	<u>100,693</u>	<u>(2,274)</u>
Expenditures				
Public works:				
Administration	12,674	12,674	12,674	-
Utilities - routine	23,600	23,600	26,635	3,035
Payroll taxes - routine	10,500	10,500	7,164	(3,336)
Supplies - routine	3,500	3,500	1,371	(2,129)
Repairs and maintenance - routine	2,900	2,900	5,151	2,251
Salt contracts - snow	6,500	6,500	4,592	(1,908)
Capital projects	585,000	30,781	-	(30,781)
Total expenditures	<u>644,674</u>	<u>90,455</u>	<u>57,587</u>	<u>(32,868)</u>
Revenues over expenditures	<u>43,293</u>	<u>12,512</u>	<u>43,106</u>	<u>30,594</u>
Other financing sources (uses)				
Transfers in	-	20,000	20,000	-
Transfers out	(155,761)	(124,980)	(122,014)	2,966
Total other financing sources (uses)	<u>(155,761)</u>	<u>(104,980)</u>	<u>(102,014)</u>	<u>2,966</u>
Net change in fund balance	<u>(112,468)</u>	<u>(92,468)</u>	<u>(58,908)</u>	<u>33,560</u>
Fund balance, beginning of year	<u>63,559</u>	<u>63,559</u>	<u>63,559</u>	<u>-</u>
Fund balance, end of year	<u>\$ (48,909)</u>	<u>\$ (28,909)</u>	<u>\$ 4,651</u>	<u>\$ 33,560</u>

CITY OF GRAYLING
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
LOCAL STREET FUND
For the Year Ended June 30, 2008

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Intergovernmental	\$ 45,411	\$ 45,411	\$ 47,404	\$ 1,993
Interest and rent	500	500	41	(459)
Total revenues	<u>45,911</u>	<u>45,911</u>	<u>47,445</u>	<u>1,534</u>
Expenditures				
Public works:				
Administration	9,821	9,821	9,821	-
Utilities - routine	9,913	9,913	7,694	(2,219)
Supplies - routine	2,500	2,500	1,332	(1,168)
Professional services - routine	-	-	125	125
Repairs and maintenance - routine	-	-	1,456	1,456
Salt contracts - snow	7,500	7,500	5,217	(2,283)
Total public works expenditures	<u>29,734</u>	<u>29,734</u>	<u>25,645</u>	<u>(4,089)</u>
Revenues over expenditures	<u>16,177</u>	<u>16,177</u>	<u>21,800</u>	<u>5,623</u>
Other financing sources (uses)				
Transfers in	87,835	97,835	73,018	(24,817)
Transfers out	(104,012)	(104,012)	(93,546)	10,466
Total other financing uses	<u>(16,177)</u>	<u>(6,177)</u>	<u>(20,528)</u>	<u>(14,351)</u>
Net change in fund balance	-	10,000	1,272	(8,728)
Fund balance, beginning of year	<u>5,824</u>	<u>5,824</u>	<u>5,824</u>	<u>-</u>
Fund balance, end of year	<u>\$ 5,824</u>	<u>\$ 15,824</u>	<u>\$ 7,096</u>	<u>\$ (8,728)</u>

CITY OF GRAYLING
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
CEMETERY FUND
For the Year Ended June 30, 2008

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Intergovernmental	\$ 32,516	\$ 32,516	\$ 26,906	\$ (5,610)
Charges for services	13,000	13,000	20,234	7,234
Interest and rent	15,000	15,000	16,033	1,033
Total revenues	<u>60,516</u>	<u>60,516</u>	<u>63,173</u>	<u>2,657</u>
Expenditures				
General government	<u>142,433</u>	<u>157,333</u>	<u>59,525</u>	<u>(97,808)</u>
Revenues over (under) expenditures	<u>(81,917)</u>	<u>(96,817)</u>	<u>3,648</u>	<u>100,465</u>
Other financing sources (uses)				
Transfers in	32,516	32,516	470,594	438,078
Transfers out	<u>(26,500)</u>	<u>(26,500)</u>	<u>(51,528)</u>	<u>(25,028)</u>
Total other financing sources (uses)	<u>6,016</u>	<u>6,016</u>	<u>419,066</u>	<u>413,050</u>
Net change in fund balance	<u>(75,901)</u>	<u>(90,801)</u>	<u>422,714</u>	<u>513,515</u>
Fund balance, beginning of year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Fund balance, end of year	<u><u>\$ (75,901)</u></u>	<u><u>\$ (90,801)</u></u>	<u><u>\$ 422,714</u></u>	<u><u>\$ 513,515</u></u>

CITY OF GRAYLING
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
MUNICIPAL HOLDINGS FUND
For the Year Ended June 30, 2008

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Interest and rent	\$ 127,514	\$ 127,514	\$ 127,751	\$ 237
Expenditures				
General government	65,131	75,131	62,118	(13,013)
Revenues over expenditures	62,383	52,383	65,633	13,250
Other financing sources (uses)				
Transfers in	-	10,000	-	(10,000)
Transfers out	(60,258)	(60,258)	(37,581)	22,677
Total other financing sources (uses)	(60,258)	(50,258)	(37,581)	12,677
Net change in fund balance	2,125	2,125	28,052	25,927
Fund balance, beginning of year	-	-	-	-
Fund balance, end of year	<u>\$ 2,125</u>	<u>\$ 2,125</u>	<u>\$ 28,052</u>	<u>\$ 25,927</u>

CITY OF GRAYLING
Statement of Net Assets
Housing Commission Component Unit
March 31, 2008

	Enterprise Fund
Assets	
Cash and equivalents	\$ 157,032
Investments	54,514
Accounts receivable	3,655
Prepaid expenses	5,285
Inventory	2,475
Capital assets, net	<u>1,148,072</u>
Total assets	<u>\$ 1,371,033</u>
Liabilities	
Accounts payable	18,356
Accrued liabilities	70,030
Other non-current liabilities	<u>39,640</u>
Total liabilities	<u>128,026</u>
Net assets	
Invested in capital assets, net of related debt	1,148,072
Restricted net assets	100,180
Unrestricted (deficit)	<u>(5,245)</u>
Total net assets	<u><u>\$ 1,243,007</u></u>

CITY OF GRAYLING
Statement of Activities
Housing Commission Component Unit
For the Year Ended March 31, 2008

	Enterprise Fund
Expenditures/expenses	
Public housing	\$ 989,526
Program revenues	
Charges for services	253,082
Operating grants and contributions	713,269
Total program revenues	966,351
Net program revenue (expense)	(23,175)
General revenues	
Unrestricted investment earnings	2,563
Other	3,775
Total general revenues	6,338
Change in net assets	(16,837)
Fund balances/net assets	
Beginning of year	1,297,412
Prior period adjustment	(37,568)
Beginning of year, restated	1,259,844
End of year	\$ 1,243,007



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP

An Independent Member of Baker Tilly International

December 26, 2008

Honorable Mayor and
Members of the City Council
City of Grayling

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the **City of Grayling** (the "City") for the year ended June 30, 2008, and have issued our report thereon dated December 26, 2008. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America

As stated in our engagement letter dated August 5, 2008, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter and our meeting about planning matters in July 2008.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the useful lives of depreciable capital assets is based on the length of time it is believed that those assets will provide some economic benefit in the future.
- Management's estimate of the accrued compensated absences is based on current hourly rates and policies regarding payment of sick and vacation banks.
- Management's estimate of the allowance for uncollectible accounts receivable is based on past experience and future expectations for collection of various account balances and has determined to be zero.

We evaluated the key factors assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 26, 2008.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Entity's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the governing body and management of the *City of Grayling* and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink, appearing to read "Lehmann Johnson", is positioned below the typed name.

City of Grayling
Comments and Recommendations
For the Year Ended June 30, 2008

In planning and performing our audit of the financial statements of the City of Grayling (the “City”) as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the City’s internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City’s internal control. Accordingly, we do not express an opinion on the effectiveness of the City’s internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control. We consider certain deficiencies, as described below, to be significant deficiencies in internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control.

City of Grayling
Comments and Recommendations
For the Year Ended June 30, 2008

Significant Deficiencies

Finding 2008-1 - Preparation of Financial Statements in Accordance with GAAP

Criteria:	All Michigan governments are required to prepare financial statements in accordance with generally accepted accounting principles (GAAP). This is a responsibility of the government's management. The preparation of financial statements in accordance with GAAP requires internal controls over both (1) recording, processing, and summarizing accounting data (i.e., maintaining internal books and records), and (2) reporting government-wide and fund financial statements, including the related footnotes (i.e., external financial reporting.)
Condition:	As is the case with many smaller and medium-sized entities, the government has historically relied on its independent external auditors to assist in the preparation of the government-wide financial statements and footnotes as part of its external financial reporting process. Accordingly, the government's ability to prepare financial statements in accordance with GAAP is based, in part, on its reliance of its <i>external</i> auditors, who cannot by definition be considered part of the government's <i>internal</i> controls.
Cause:	This condition was caused by the government's decision that it is more cost effective to outsource the preparation of its annual financial statements to the auditors than to incur the time and expense of obtaining the necessary training and expertise required for the government to perform this task internally.
Effect:	As a result of this condition, the government lacks internal controls over the preparation of financial statements in accordance with GAAP, and instead relies, in part, on its external auditors for assistance with this task.
Official Response:	The government has evaluated the cost vs. benefit of establishing internal controls over the preparation of financial statements in accordance with GAAP, and determined that it is in the best interests of the government to outsource this task to its external auditors, and to carefully review the draft financial statements and notes prior to approving them and accepting responsibility for their content and presentation.

City of Grayling
Comments and Recommendations
For the Year Ended June 30, 2008

Other Matters

Workstation Security

When users vacate the work areas for any length of time they should be locking their workstations. Windows provides an effective workstation security system that can be invoked with one set of keystrokes. Locking a personal workstation is a basic control that limits access to accounting records by unauthorized individuals. We recommend that the City require all PC users to lock their workstations when they are unattended.

Passwords

Passwords are key controls for protecting inappropriate entry into an organizations IT system. If an individual inappropriately gains access to another person's username and password, the financial accounting records could be compromised. Because the inappropriate use of someone's username and password is not always identified, users should change their passwords on a routine basis. The systems, both network and financial, should be set so users are forced to change their passwords every six months.

Journal Entries

Our review of the general journal entries and per discussion with City personnel, it was discovered that many entries lack approval by a responsible employee other than the City Treasurer. We recommend the adoption of a policy whereby all journal entries will be approved by the City Manager. All entries should be initialed by both the City Treasurer and City Manager as evidence to their approval. All journal entries should also be accompanied by an explanation and by reference to adequate supporting data.

Bank Reconciliations

To ensure good controls, bank reconciliations should be reviewed by a responsible official and both the preparer and reviewer should initial and date the reconciliation as evidence. While the City is diligent in completing its bank reconciliations on a timely basis, we noted during our audit procedures, that bank reconciliations are not being reviewed by a responsible official other than the preparer. We recommend that to strengthen internal controls in this area, bank reconciliations should be reviewed by a responsible official with a working knowledge of the City's bank accounts. To document the preparation and subsequent review, bank reconciliations should be initialed and dated by both the preparer and reviewer.

* * * * *